Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of:	)	
	)	**WC Docket No. 07-135**
Establishing Just and Reasonable Rates For Local Exchange Carriers	)	

PETITION FOR FORBEARANCE

Embarq Local Operating Companies
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December 17, 2007

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COMMENTS OF EMBARQ CORP.

I. INTRODUCTION AND SUMMARY

The Commission has initiated this rulemaking to review its rules governing tariffing of traffic-sensitive switched access services by local exchange carriers ("LECs').[1] The Commission is concerned by allegations that some small, average schedule LECs have partnered with providers of free conference calling or other services to grossly inflate terminating access traffic volumes in ways that yield manifestly unjust and unreasonable access rates paid by interexchange carriers ("IXCs"). Because the Commission's rules governing these small, rate-of-return LECs access rates presume relatively balanced traffic and low and relatively steady volumes, those regulations inadvertently have allowed an opportunity for inflating access charges that a handful of small rural LECs plainly have abused.

[1] Establishing Just and Reasonable Rates for Local Exchange Carriers:, Notice of Proposed Rulemaking, WC Docket No. 07-135, FCC 07-176 (rel. Oct. 2, 1997) ("NPRM").

Embarq Corporation is the nation's fourth largest LEC. Its local operating companies serve approximately 6.7 million access lines. Embarq's service territories are chiefly rural.[2] At the federal level, Embarq is purely a price cap carrier, although four of the smallest of its nineteen operating companies remain intrastate rate-of-return carriers. Given its markets and its history, Embarq understands the difficulties of providing services in low-density, high-cost areas. It understands the changes facing incumbent LECs in today's increasingly competitive markets. It also understands the pressing need to reduce regulatory burdens in a segment of the industry that remains over-regulated. In the case of average schedule, rate-of-return LECs, however, Embarq agrees with the Commission's tentative conclusion that some limited tariff rule modifications may be warranted.

Much of what the Commission proposes, however, is unnecessary. The problems and abuses highlighted by this proceeding clearly have been limited to a very small minority of disreputable carriers and business operators. Any rule changes should be narrowly tailored and specifically targeted to the class of LECs whose tariffs are associated with this problem. For average schedule-eligible LECs, the Commission should bar re-entry to the NECA pool for six years. It should bar rate-of-return LECs from including payments to access stimulators in their revenue requirement. Although it should not forbear from enforcing statutory "deemed lawful" treatment for their filed tariffs, it should consider refiling triggers if an average schedule-eligible LEC's traffic

2 Embarq is a rural carrier, under the definition of the Act, in all but one of the eighteen states in which it provides service. Its local operating companies are listed in Appendix A.

increases more than 50% in a year, subject to waiver. These steps, combined with the Commission's existing enforcement authority and rules, should be sufficient to prevent average schedule LECs from inflating access rates and grossly inflating access traffic demand by partnering with traffic stimulators. At the same time, these steps would ensure responsible rate of return LECs are not harmed by the bad conduct of few disreputable players.

While Embarq shares the Commission's concern about traffic pumping abuses by a handful of small, average schedule LECs, other access abuses need prompt Commission attention. The Commission needs to act promptly on phantom traffic, and it needs to ensure that LECs are fully compensated for IP-originated traffic carried or terminated on the PSTN. Ultimately, these access arbitrage schemes have a far more damaging and lasting impact on the public interest.

II. BACKGROUND

Rate-of-return ILECs calculate access charges on the basis of costs and demand, filing tariffs with the Commission every two years.[3] They can file tariffs based on their actual costs and demand, or they can join tariff pools managed by the National Exchange Carrier Association ("NECA"). NECA pool members can either send their own monthly cost data to NECA to calculate access settlement, or they can operate as average schedule carriers and receive settlements calculated using formulas set each year by NECA and approved by the Commission. The average schedule formula simulates the revenue

[3] 47 U.S.C. § 203. A tariff is a common carrier's publicly-filed listing of rates and regulations. 47 C.F.R. § 61.3(rr).

needs and the FCC-approved 11.25% approved rate of return of the sample of participating LECs. Participating LECs then pool their access revenue. These streamlined tariff procedures are set out in section 61.38 of the Commission's rules.[4]

The very smallest rate of return LECs,[5] however, can choose an even more streamlined tariffing procedure. Instead of submitting monthly cost data, they can calculate their traffic-sensitive rates based on historic costs and demand, as though they had remained in the NECA pool. These tariff procedures are set out in section 61.39.[6] These tariffs can be challenged in a complaint proceeding, and the Commission can order prospective rate changes if the rate of return exceeds the prescribed amount.[7]

The Commission's tariffing rules for rate-of-return LECs generally have served the public, the marketplace, and carriers well. Circumstances leading to this NPRM, however, show that some rural LECs and CLECs or conferencing providers have teamed together to abuse rules that presumed stable and balanced traffic volumes. A small handful of average schedule LECs have inflated traffic volumes vastly above historical volumes, yet have applied access rates based on knowingly inappropriate historical or average costs.

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[4] 47 C.F.R. § 61.38.

[5] This procedure is limited to LECs with 50,000 or less access lines and annual operating revenues below $40 million.

[6] 47 C.F.R. § 61.39.

[7] Regulation of Small Telephone Cos., Report and Order, 2 FCC Rcd 3811 at ¶ 14 (1987).

Among them is Farmers and Merchants Mutual Telephone Company, which was the subject of a recent complaint brought before the Commission under section 208.[8] It has been a NECA pool rural LEC, and historically served about 800 lines in Wayland, Iowa (population 838). It provides local exchange and exchange access services pursuant to tariffs filed with the Iowa Utilities Board and the Commission.

The Commission found that Farmers entered a prearranged plan to vastly inflate usage on its network, and as part of this plan, it left the NECA pool. Joining with a free-conferencing service partner, it grew its traffic explosively. Then, to avoid having to reset its rates based on its now-vastly greater traffic volumes, which would have yielded far lower rates, it re-entered the NECA pool and adopted rates based on average schedule LEC costs. After Qwest filed a complaint challenging this manipulation of Commission rules, the Commission agreed that "the conclusion that Farmers vastly exceeded the prescribed rate of return is inescapable."[9] Farmers' revenues increased many fold, yet its terminating access rates continued to reflect costs of a small rural carrier with little traffic or revenue.

The Wall Street Journal profiled a similar example in a recent front page story.[10] In that case, the newspaper reported, the rural LECs' minutes of use ("MOU") were just

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[8] 47 U.S.C. § 208; Qwest Comms. Corp., Complainant, v. Farmers and Merchants Mut. Tel. Co., Defendant, Memo. Op. and Order, FCC 07-175 (rel. Oct. 2, 2007) ("Qwest Order") ("Qwest Order").

[9] See Qwest Order at ¶ 25.

[10] "How 2 Guys' Iowa Connection Took Big Telecoms for a Ride," Wall Street Journal, Oct. 4, 2007 at A1, col. 5.

121,000 in January 2005. In December 2006, its MOU hit 15 million minutes, perhaps 99% of usage attributable solely to free calling services.[11] Its tariffed access charges, however, did not reflect those vastly inflated volumes. Other examples of these abuses are highlighted in the NPRM.[12]

III. PROPOSED RULE CHANGES

A. Rule Changes for Rate-of-Return LECs (NPRM ¶ 11).

Given such abuses, the Commission has tentatively concluded that it should revise tariff rules to ensure tariffed rates remain just and reasonable even if a carrier experiences or induces significant increases in access demand. The Commission has also tentatively concluded that it is a violation of section 201(b) to have revenue sharing or other compensation arrangements with end users.

The Commission has long claimed that section 201(b)[13] gives it authority, whether in response to complaints or at its own initiative, to take measures necessary to ensure rates and terms are just and reasonable. Given that authority, major tariffing rule changes for rate-of-return LECs are unnecessary. Under existing procedures, improper access stimulation can be recognized, examined, and stopped by the Commission. The Commission does not need to modify its enforcement rules to address improper access

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[11] Id. at A14, col. 3.

[12] See NPRM ¶ 11 n.37. Several IXCs have brought complaints against rate-of-return LECs alleging that schemes have yielded grossly inflated rates of return.

[13] 47 U.S.C. § 201(b).

stimulation. The Commission should limit its action here to a few, narrowly-tailored revisions of its tariff rules governing section 61.38 or 61.39 rate-of-return LECs.

B. <u>Revenue Sharing</u> (NPRM ¶ 18)

The Commission notes that at least some LECs involved in access stimulation activities have been encouraging this activity by sharing revenue with traffic stimulators. All carriers should promote usage of their networks. Increased usage ordinarily tends to reduce costs for all users of the network, supports network investment and upgrades, and may reduce the need for high-cost universal service support. The Commission should not automatically deem compensation payments to be unlawful in violation of sections 201, 202, and 203 of the Act.[14] The Commission's focus should be whether the LEC's access rate is just and reasonable, based on a realistic assessment of its rate of return. Some revenue sharing arrangements may be benign or even beneficial to the public interest. Ending NECA "pool hopping" and adopting a tariff refilling trigger, as proposed separately in the NPRM, will help to prevent these traffic stimulation abuses without needing to bar revenue sharing arrangements across the board. The Commission should, however, prohibit rate of return LECs from including in their access costs any compensation payments paid to access stimulators.

[14] 47 U.S.C. §§ 201, 202, 203.

C. <u>Tariff Language and Access Traffic Growth Rate</u> (NPRM ¶¶ 21-22)

The Commission proposes to require carriers to refile tariffs if abrupt increases in demand are large enough to cause excessive rates of return.[15] Embarq agrees that it may not be unreasonable for the Commission to require section 61.38 and 61.39 NECA pool LECs to include language in their tariff reflecting such a trigger.

Where an average schedule LEC experiences sudden and dramatic increases in switched access minutes, a tariff refilling trigger may make sense, if set at an appropriately high level. Embarq would suggest setting a trigger at no lower than a 50% traffic increase. Any comparison should be to the same month in the prior year, so as to avoid season fluctuations. It may also be appropriate to utilize more than one month in the comparison, to avoid unusual and temporary spikes in traffic. The Commission could use an average of the more recent three months, or a quarterly model. To keep the rules simple, the Commission could apply the same trigger for section 61.38 and 61.39 LECs, and apply it whether the traffic increase is exogenous or endogenous in origin. Where a dramatic spike in traffic triggers this requirement but is temporary or attributable to an extraordinary event, the Commission can grant waiver of the rule.[16]

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[15] The NPRM proposes that average schedule LEC tariffs include a statement such as this:

> If the monthly local switching minutes of the issuing carrier exceeds ___% of the local switching demand of the same month of the preceding year, the issuing carrier will filed revised local switching and transport tariff rates to reflect this increased demand within ___ days of the end of that month.

[16] 47 C.F.R. § 1.3.

D. <u>Tariff Filing Issues</u> (NPRM ¶ 23)

Embarq recognizes the difficulties associated with short tariff filing deadlines. The NECA "tariff-hopping" cases brought to the Commission's attention, however, suggest that where small rate of return LECs experience the dramatic increases in traffic sufficient to meet this trigger, the circumstances usually will not be a surprise to the carrier. Accordingly, a relatively short, sixty day deadline would seem reasonable. Where LECs fairly reasonably need additional time to file, the Commission can provide a waiver to allow additional time to file an updated tariff, or to excuse a reasonable failure to meet the filing deadline.

E. <u>Carrier Certification</u> (NPRM ¶¶ 27-28)

In adopting streamlined tariffing rules for section 61.38 and 61.39 LECs, the Commission adopted "historical average schedule settlements as a basis for rate setting because it believed that this data would be a 'reasonable proxy' for future costs."[17] The Commission has asked whether it should require average schedule LECs to certify, at the time of tariff filing, that they are not currently stimulating traffic and will not do so during the tariff period.

Although Embarq shares the Commission's concern about abuse of tariffing rules by a handful of small rate-of-return LECs, it believes certifications should be unnecessary. First, prohibiting average schedule LECs from re-entering the NECA pool and adopting a tariff refilling trigger should shorten and therefore sharply limit

[17] NPRM ¶ 28.

opportunities for this abuse. Second, affected IXCs can challenge tariffed access charges before the Commission, if only prospectively. Third, the Commission claims authority under section 201(b) to address unjust and unreasonable rates by average schedule LECs.

If the Commission were, however, to adopt a certification requirement, it should simply provide that the average schedule LEC believes that its use of historical average schedule settlement data to determine its rates is a reasonable predictor of its future costs. It would probably be impractical, however, to try to fashion a requirement to bring to the Commission's attention any significant operational changes that could materially affect the reasonableness of a LEC's rates.

F. Possible Forbearance (NPRM ¶¶ 29-30)

The Commission has asked whether it should remove section 204(a)(3)'s "deemed lawful" status for filed tariffs of rate of return LECs,[18] such as by forbearing from enforcing that section.[19] Such a step would be an abrupt departure from existing tariff law, and both inappropriate and unnecessary.

From 1934 onward, the Commission traditionally prohibited retroactive ratemaking. After the AT&T divestiture, the Commission departed from that longstanding practice, and allowed AT&T to seek refunds of tariffed LEC charges. The

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[18] 47 U.S.C. § 204(a)(3). This section provides that LEC tariff filings shall be made "on a streamlined basis" and "shall be deemed lawful and shall be effective 7 days (in the case of a reduction in rates) or 15 days (in the case of an increase in rates) … unless the Commission takes action" to suspend the filing pending a hearing.

[19] Section 10 of the Telecommunications Act of 1996 provides for forbearance when statutory conditions are met. 47 U.S.C. § 160.

D.C. Circuit reluctantly upheld the Commission's practice, but voiced concern that carrier that acted lawfully and met all tariffing requirements could nevertheless be forced to issue refunds.[20] The Commission's practice, the court explained, had the effect of leaving LECs forever in "almost endlessly suspended animation," because they always faced the risk of paying refunds.[21] In 1996, Congress streamlined the tariff process and removed the Commission's refund authority by incorporating section 204(a)(3) into the Telecommunications Act.[22]

Since then, the "deemed lawful" provision has saved the Commission and LECs the many burdens previously associated with annual tariff reviews. Instead, the Commission has been able to limit investigation to individual tariff filings that have had some particular need for review. The provision has also protected carriers from retroactive ratemaking by the Commission – a restriction consistent with the 1996 Act's deregulatory goals.

The Act and the Commission's rules already give the Commission authority to prevent deemed lawful treatment for those tariffs that it believes warrant investigating.[23] Forbearing from the Act's "deemed lawful" provision would impose an unreasonable burden on an entire industry, simply because of the isolated misconduct of a handful of

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[20] ACS of Anchorage, Inc. v. FCC, 290 F.2d 403 (D.C. Cir. 2002).

[21] Id. at 412.

[22] Pub. L. No. 104-104, 110 Stat. 56 (1996) ("1996 Act").

[23] 47 U.S.C. § 204(a)(3); Implementation of Section 402(b0(1) of the Telecommunications Act of 1996, Order, 12 FCC Rcd 2170 at ¶¶ 67-68 (1997), recon. on other grds., 17 FCC Rcd 17039 (2002). Indeed, the Commission too often suspends tariffs indefinitely.

some of the smallest industry players. Forbearing from section 204(a)(3) also would be inconsistent with the plainly deregulatory goals of the 1996 Act in general and of section 10 in particular. Congress intended forbearance as a means of reducing regulatory burdens on carriers, not increasing them.

Forbearing from enforcing the "deemed lawful" provision of section 204(a)(3) should be unnecessary, in any event. Prohibiting NECA "pool hopping" and adopting a tariff refilling trigger for average schedule LECs, as proposed elsewhere in the NPRM, would prevent the abuses without undermining the Act's deregulatory goals.

G. <u>NECA Pool Participation</u> (NPRM ¶ 32)

The Commission never envisioned that any average schedule LECs would repeatedly enter and exit the NECA pool to game access calculations. Embarq believes carriers experiencing genuinely dramatic increases in traffic after leaving the NECA pool should be precluded from re-entering the pool, until it has operated six years under its own rate-of-return tariff.

For a LEC otherwise eligible for the NECA pool, banning re-entry for six years would force it to re-adjust rates for the next tariff cycle based on more current cost and demand data. Prohibiting NECA "pool hopping" would be simple, efficient, and non-intrusive for the vast majority of responsible LECs that do not participate in the schemes described in the NPRM. It would be effective in minimizing access tariff abuse. By limiting the time period in which an average schedule LEC can engage in traffic stimulation, this rule change would substantially reduce the incentive for rate of return LECs to artificially inflate access returns by manipulating the tariff rules. In the meantime, the Commission would continue to have its authority to compel rate changes in the course of enforcement proceedings.[24]

H. <u>Price Cap LECs</u> (NPRM ¶ 33)

Price cap LECs are subject to a different regulatory regime -- one that focuses not on earnings but on prices.[25] Price cap LECs are subject to price ceilings, which give them pricing flexibility while ensuring that their interstate access rates are just and reasonable.[26] The access stimulation abuses brought before the Commission, and highlighted in the NPRM, are not associated with price cap carriers. All carriers strive to promote usage on their networks – indeed, that is the responsible course for any carrier – but virtually by definition price cap carriers do not have the ability to grossly inflate their rates of return on interstate access by teaming with traffic stimulators. Price cap carriers have no guaranteed rate of return. Their rates are not set by relation to a pool of carriers, whose costs and demand mask the individual LEC's own. They operate in more competitive markets. In addressing the problem of traffic stimulation by rate of return LECs, the Commission should make no changes to tariff rules for price cap carriers.[27]

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[24] The Commission could always requests for waiver of this prohibition on a case by case basis, where circumstances warrant deviation from this rule.

[25] <u>Policy and Rules Concerning Rates for Dominant Carriers</u>, Second Report and Order, 5 FCC Rcd 6786 (1990).

[26] 47 C.F.R. §§ 61.41-49.

[27] If a party believes it has evidence that a price cap LEC's tariffed rates, terms, or conditions are unlawful, it can bring a complaint before the Commission or in court. 47 U.S.C. §§ 206-208.

IV. THE COMMISSION ALSO NEEDS TO ACT PROMPTLY TO STOP ACCESS AVOIDANCE SCHEMES.

It is appropriate for the Commission to take steps to address the access rate abuses being committed by a relative handful of small rate of return LECs. The Commission also needs to act on the far more widespread problem of unlawful access avoidance.

LECs provide the public switched telephone network ("PSTN") – the facilities on which the great majority of the nation's communications depend. The PSTN provides the network essential for wireline, wireless, and broadband services. It is essential that all users of the PSTN pay their share of the costs of operating, maintaining, and continually upgrading that network.

The Commission needs to address the growing problem of "phantom traffic" – traffic that LECs are forced to carry but cannot identify and bill. Too many carriers are mischaracterizing traffic – and in some cases deliberately miscoding traffic – to avoid paying the access charges that support the PSTN and its continued investment. Too many service providers are misapplying the ESP exemption, by presuming that it allows them to route nonlocal interconnected VoIP traffic to the PSTN for termination without paying terminating access charges.

These and other access avoidance schemes ultimately pose a greater threat to the public interest than the abuses highlighted by the NPRM. While Embarq shares the Commission's concern about traffic pumping abuses by a handful of small, average schedule LECs, the Commission needs to act promptly on phantom traffic, and it needs to ensure that LECs are fully compensated for IP-originated traffic carried or terminated on the PSTN.

Respectfully submitted,

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December 17, 2007

APPENDIX A

EMBARQ LOCAL OPERATING COMPANIES
Subsidiaries of Embarq Corporation

Central Telephone Company d/b/a Embarq
Central Telephone Company of Texas, Inc. d.b.a Embarq
Central Telephone Company of Virginia d/b/a Embarq
Embarq Florida, Inc.
United Telephone Company of Indiana, Inc. d/b/a Embarq
United Telephone Company of Eastern Kansas d/b/a Embarq
United Telephone Company of Kansas d/b/a Embarq
United Telephone Company of Southcentral Kansas d/b/a Embarq
Embarq Minnesota, Inc.
Embarq Missouri, Inc.
Carolina Telephone and Telegraph Company d/b/a Embarq
United Telephone Company of the West d/b/a Embarq
United Telephone Company of New Jersey, Inc. d/b/a Embarq
United Telephone Company of Ohio d/b/a Embarq
United Telephone Company of the Northwest d/b/a Embarq
United Telephone Company of Pennsylvania d/b/a Embarq
United Telephone Company of the Carolinas d/b/a Embarq
United Telephone-Southeast, Inc. d/b/a Embarq
United Telephone Company of Texas, Inc. d/b/a Embarq